Third, the bill provides that the determination of the amount of underpayment shall not be less than the amount that would be determined if the items not attributable to a tax shelter or to a transaction having disallowed noneconomic tax attributes (discussed below) were treated as being correct. Finally, an underpayment may not be reduced by reason of filing an amended return after the taxpayer is first contacted by the IRS regarding the examination of its return.

EFFECTIVE DATE

The enhanced penalty applies to transactions after the date of enactment. The modifications to the substantial understatement penalty apply to taxable years ending after the date of enactment.

2. Promoter penalties (sec. 202)

PRESENT LAW

Any person who (1) organizes any partnership, entity, plan, or arrangement, or (2) participates in the sale of any interest in such a structure, and makes or furnishes a statement (or causes another to make or furnish a statement) with respect to any material tax benefit attributable to the arrangement or structure that the person knows (or has reason to know) is false or fraudulent is subject to a penalty. The amount of the penalty is equal to the lesser of (1) $1,000 or (2) 100 percent of the gross income derived by the promoter from each activity (sec. 6700(a)). There is no statute of limitations on the assessment of a penalty under section 6700 (*Capozzi* v. *Commissioner*, 980 F.2d 872 (2nd Cir. 1992); *Lamb* v. *Commissioner*, 977 F.2d 1296 (8th Cir. 1992)).

EXPLANATION OF PROVISION

The bill imposes a penalty on any substantial promoter of a tax avoidance strategy if the strategy fails to satisfy any of the judicial doctrines that may be applied in the disallowance of noneconomic tax attributes (as described in section 201 of the bill).

A tax avoidance strategy means any entity, plan, arrangement, or transaction a significant purpose of which is the avoidance or evasion of Federal income tax. A substantial promoter means any person (and any related person) who participates in the promotion, offering, or sale of a tax avoidance strategy to more than one potential participant and for which the person expects to receive aggregate fees in excess of $500,000.

The IRS can assess a penalty on a promoter independent of the taxpayer's audit, and the promoter can challenge the penalty prior to a final determination with respect to the taxpayer's disallowed tax benefit. The promoter can challenge the imposition of the penalty in court independent of any litigation with the taxpayer.

The amount of the penalty equals 100 percent of the gross income derived (or to be derived) by the promoter from the strategy. This would include contingent fees, rebated fees, and fees that are structured as an interest in the transaction. Coordination rules are provided to avoid the imposition of multiple penalties on promoters (i.e., the penalty does not apply if a penalty is imposed on the substantial promoter for promoting an abusive tax shelter under present-law section 6700(a)). As under present-law section 6700, there is not statute of limitations on the assessment of the penalty.

The bill also increases the present-law promoter penalty to the greater of $1,000 or 100 percent of the gross income derived (or to be derived) by the promoter from each activity.

EFFECTIVE DATE

The penalty for promoting tax avoidance strategies applies with respect to any interest in a tax avoidance strategy that is offered after the date of enactment. The increase in the present-law penalty for promoting abusive tax shelters applies to transactions after the date of enactment.

3. Modifications to the aiding and abetting penalty (sec. 203)

PRESENT LAW

A penalty is imposed on any person who aids, assists in, procures, or advises with respect to the preparation or presentation of any return or other document if (1) the person knows (or has reason to believe) that the return or other document will be used in connection with any material matter arising under the tax laws, and (2) the person knows that if the portion of the return or other document were so used, an understatement of the tax liability would result (sec. 6701). An exception is provided for individuals who furnish mechanical assistance with respect to a document.

The amount of the penalty is $1,000 for each return or other document ($10,000 in the case of returns and documents relating to the tax of a corporation).

EXPLANATION OF PROVISION

The bill modifies the aiding and abetting penalty as it relates to any person who offers an opinion regarding the tax treatment of an item attributable to a tax shelter or any other transaction involving a noneconomic tax attribute.

Under the bill, a penalty is imposed on any person who is involved in the creation, sale, implementation, management, or reporting of a tax shelter, or of any partnership, entity, plan or arrangement that involves the disallowance of a noneconomic tax attribute (as described in section 201 of the bill), but only if (1) the person opines, advises, or indicates that the taxpayer's treatment of an item attributable to such a transaction would more likely than not prevail or not give rise to a penalty, and (2) the opinion, advice, or indication is unreasonable. If the opinion involved a higher standard (for example, a 'should opinion), and the opinion was unreasonable, then the person who offered the opinion would be subject to the proposed penalty. An opinion would be considered unreasonable if a reasonably prudent and careful person under similar circumstances would not have offered such an opinion.

The amount of the penalty is 100 percent of the gross proceeds derived by the person from the transaction. In addition, upon the imposition of this penalty, the Secretary is required to notify the IRS Director of Practice and any appropriate State licensing authority of the penalty and the circumstances under which it was imposed. Also, the Secretary must publish the identity of the person and the fact that the penalty was imposed on the person.

EFFECTIVE DATE

The provision applies to transactions entered into after date of enactment.

4. Penalty for failure to maintain list of investors (sec. 204)

PRESENT LAW

Any person who organizes a potentially abusive tax shelter or who sells an interest in such a shelter must maintain a list that identifies each person who purchased an interest in the shelter (sec. 6112). A potentially abusive tax shelter means (i) any tax shelter with respect to which registration is required under section 6111, and (ii) any entity, investment plan or arrangement, or any other plan or arrangement that is of a type that has a potential for tax avoidance or evasion and that is designated in regulations issued by the Secretary. The investor list must include the name, address and taxpayer identification number of each purchaser, as well as any other information that the Secretary may require. The lists must generally be maintained for seven years.

The penalty for any failure to meet any of the requirements of this provision if $50 for each person with respect to whom there is a failure, up to a maximum of $50,000 in any calendar year. The penalty is not imposed where the failure is due to reasonable cause and not due to willful neglect. This penalty is in addition to any other penalty provided by law.

EXPLANATION OF PROVISION

The bill increases the penalty for the failure to maintain investor lists in connection with the sale of interests in a tax shelter (as defined in section 6662(d)(2)(C)(iii) or in any partnership, entity, plan or arrangement that involves the disallowance of a noneconomic tax attribute (as described in section 201 of the bill). In these cases, the penalty is equal to the greater of 50 percent of the gross proceeds derived (or to be derived) from each person with respect to which there was a failure (with no maximum limitation).

EFFECTIVE DATE

The increased penalty applies to transactions entered into after date of enactment.

5. Penalty for failure to disclose reportable transactions (sec. 205)

PRESENT LAW

A taxpayer must file a return or statement in accordance with the forms and regulations prescribed by the Secretary (including any required information). (See Section 6011). In February 2000, the Treasury Department issued temporary and proposed regulations under section 6011 that require corporate taxpayers to include in their tax return information with respect to certain large transactions with characteristics that may be indicative of tax shelter activity.

Specifically, the regulations require the disclosure of information with respect to ''reportable transactions.'' There are two categories of reportable transactions. The first category covers transactions that are the same as (or substantially similar to) tax avoidance transactions the IRS has identified in published guidance (a ''listed'' transaction) and that are expected to reduce a corporation's income tax liability by more than $1 million in any year or by more than $2 million for any combination of years. (Treas. Reg. sec. 1.6011–4T(b)(2) and –(b)(4)). The second category covers transactions that are expected to reduce a corporation's income tax liability by more than $5 million in any single year or $10 million for any combination of years and that exhibit at least two of six enumerated characteristics. (Treas. Reg. sec. 1.6011–4T(b)(3) and –(b)(4)).

There is no penalty for failing to adequately disclose a reportable transaction. However, the nondisclosure could indicate that the taxpayer has not acted in ''good faith'' with respect to the underpayment. (T.D.8877).

EXPLANATION OF PROVISION

The bill imposes a penalty for failing to disclose the required information with respect to a reportable transaction (unless the failure was due to reasonable cause and not due to willful neglect). The amount of the penalty is equal to the greater of (1) five percent of any increase in Federal income tax which results from a difference between the taxpayer's treatment of the items attributable to the reportable transaction and the proper tax treatment of such items, or (2) $100,000. If the failure to disclose relates to a listed transaction (or a substantially similar transaction), the percentage rate is increased to 10 percent of any increase in tax from the transaction (or, if greater, $100,000).